

BEFORE THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Commission Review of)	
the Capacity Charges of Ohio Power)	
Company and Columbus Southern Power)	Case No. 10-2929-EL-UNC
Company)	

In the Matter of the Application of Columbus)	
Southern Power Company and Ohio Power)	
Company for Authority to Establish a Standard)	Case No. 11-346-EL-SSO
Service Offer Pursuant to Section 4928.143,)	Case No. 11-348-EL-SSO
Revised Code, in the Form of an Electric)	
Security Plan)	

In the Matter of the Application of Columbus)	
Southern Power Company and Ohio Power)	Case No. 11-349-EL-AAM
Company for Approval of Certain Accounting)	Case No. 11-350-EL-AAM
Authority)	

In the Matter of the Fuel Adjustment Clauses)	Case No. 13-1892-EL-FAC
for Ohio Power Company)	

In the Matter of the Application of Ohio Power)	
Company to Adopt a Final Implementation)	Case No. 14-1186-EL-RDR
Plan for the Retail Stability Rider)	

**DIRECT TESTIMONY OF
KELLY D. PEARCE
ON BEHALF OF AEP OHIO**

Filed: June 7, 2016

INDEX TO DIRECT TESTIMONY OF
KELLY D. PEARCE

Personal Data1

Purpose of Testimony3

Background.....4

OVEC and Lawrenceburg Demand Charges7

Capacity Costs Incurred.....8

Amount of Under-recovery of Capacity Costs10

THE PUBLIC UTILITIES COMMISSION OF OHIO
DIRECT TESTIMONY OF
KELLY D. PEARCE
ON BEHALF OF
OHIO POWER COMPANY

1 **PERSONAL DATA**

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3 A. My name is Kelly D. Pearce. My business address is 1 Riverside Plaza, Columbus, Ohio
4 43215.

5 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

6 A. I am employed as Director - Contracts and Analysis for American Electric Power Service
7 Corporation (“AEPSC”), a wholly owned subsidiary of American Electric Power
8 Company, Inc. (“AEP”). AEP is the parent company of Ohio Power Company (“AEP
9 Ohio” or the “Company”).

10 **Q. PLEASE DESCRIBE YOUR CURRENT RESPONSIBILITIES.**

11 A. My group is responsible for performing financial and other analyses concerning AEP’s
12 generation resources and load obligations; settlement support for AEP’s operating
13 companies, including that associated with certain affiliate agreements and the PJM
14 regional transmission organization; and regulatory support in areas that relate to
15 commercial operations. In addition, my group is responsible for AEP’s wholesale
16 formula rate agreements.

17 **Q. PLEASE BRIEFLY DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL**
18 **BACKGROUND.**

1 A. I received a Bachelor of Science degree in Mechanical Engineering from Oklahoma State
2 University in 1984. I received Master of Science and Doctor of Philosophy degrees in
3 Nuclear Engineering from the University of Michigan in 1986 and 1991 respectively. I
4 received a Master of Science in Industrial Administration degree from Carnegie Mellon
5 University in 1994.

6 From 1986 to 1988, I worked for a subsidiary of Olin Corporation. From 1991 to
7 1996, I worked for the United States Department of Energy within the Office of Fossil
8 Energy. My responsibilities included serving as a Contracting Officer's Representative
9 in the oversight and administration of government-funded research of advanced
10 generation and environmental remediation technologies and projects. I also supported
11 strategic studies for deployment and commercialization of these technologies, as well as
12 administration and support of government research and development solicitations. I was
13 promoted twice during this time.

14 In 1996, I joined AEPSC as a Rate Consultant I in Regulatory Services. In 2001,
15 I was promoted to Senior Regulatory Consultant. My responsibilities included
16 preparation of class cost-of-service studies and rate design for AEP operating companies
17 and the preparation of special contracts and regulated pricing for retail customers. In
18 2003, I transferred to Commercial Operations as Manager of Cost Recovery Analysis. In
19 2007, I was promoted to Director of Commercial Analysis. During this period, I was
20 responsible for analyzing the financial impacts of Commercial Operations-related
21 activities. I also supported settlement of AEP's generation pooling agreements among
22 the operating companies. In 2010, I transferred to Regulatory Services in my current
23 position.

1 I am a registered Professional Engineer in Ohio and West Virginia.

2 **Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY IN ANY REGULATORY**
3 **PROCEEDINGS?**

4 A. Yes. I submitted testimony and testified before the Public Utilities Commission of Ohio
5 (“Commission”) in Case Nos. 11-346-EL-SSO et al. (the “*ESP II*” proceeding), and 10-
6 2929-EL-UNC (the “*Capacity Charge*” proceeding) on behalf of AEP Ohio.

7 I submitted testimony to the Virginia State Corporation Commission (“VSCC”) in
8 Case Nos. PUE-2001-00011 and PUE-2011-00034 and submitted testimony and testified
9 before the VSCC in Case No. PUE-2001-00306. I also testified before the Indiana Utility
10 Regulatory Commission in Cause No. 43992 and the Kentucky Public Service
11 Commission in Case No. 2014-00225. I also submitted testimony to the Federal Energy
12 Regulatory Commission in Docket No. ER13-539-000. My testimony in all of these
13 proceedings was on behalf of operating companies that are affiliates of AEP Ohio.

14 **PURPOSE OF TESTIMONY**

15 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

16 A. The purpose of my testimony is to provide a calculation of the applicable incurred
17 capacity costs that are subject to recovery under the state compensation mechanism
18 (“SCM”) that includes the corrected energy credit as supported by Company witness
19 Allen. As a related matter, I will demonstrate that the Company’s incurred costs have
20 exceeded the rate authorized for recovery in the *Capacity Charge* case excluding Ohio
21 Valley Electric Corporation (“OVEC”) and Lawrenceburg capacity charges, which
22 demonstrates that there has been no double recovery of capacity costs.

1 **BACKGROUND**

2 **Q. PLEASE DESCRIBE THE RESULTS OF THE *CAPACITY CHARGE* CASE.**

3 A. The *Capacity Charge* case resolved the issue of what Competitive Retail Electric Service
4 (“CRES”) providers would pay to the Company for the Company’s capacity utilized to
5 serve their customers. The Company was required per PJM rules to commit the required
6 capacity resources three years in advance and had done so as a part of its Fixed Resource
7 Requirement (“FRR”) Plan. The Company proposed a cost-based rate that would be
8 based on the Company’s most recent FERC Form 1 (“FF1”) information. Based on the
9 most recent FF1 at the time of the proceeding, this value was \$355.72/MW-day. The
10 Commission adopted a rate cap of \$188.88/MW-day, conditioned upon the Company
11 incurring capacity costs of at least \$188.88/MW-day. This rate cap included the energy
12 credit as originally proposed by the Staff’s consultant.

13 **Q. WHY DO YOU REFER TO THE \$188.88/MW-DAY CHARGE AS A RATE CAP?**

14 A. The approved rate cap to be collected by AEP Ohio was \$188.88/MW-day, based on a
15 capacity cost of \$342.95/MW-day prior to certain adjustments as presented by Company
16 witness Allen. The Commission only authorized AEP Ohio to charge CRES providers
17 the prevailing RPM rate for capacity that supports shopping load but authorized the
18 Company to “defer incurred capacity costs not recovered from CRES provider billings
19 during the ESP period to the extent that the total incurred capacity costs do not exceed
20 [\$188.88/MW-day].” *Capacity Charge* Opinion and Order at 23. Because the Company
21 would only collect a lower amount if its total capacity costs incurred during 2012-2015
22 were less than \$188.88/MW-day, it is accurate to characterize the \$188.88/MW-day

1 charge as a rate cap. In reality, the Company's incurred costs exceeded the rate cap
2 established by the Commission.

3 **Q. DID THE COMPANY TRACK ITS INCURRED COSTS AS CONTEMPLATED**
4 **BY THE *CAPACITY CHARGE* DECISION?**

5 A. Yes. The Company tracked its actual capacity costs during this period and can
6 demonstrate that its incurred costs have exceeded the rate cap, even excluding the OVEC
7 and Lawrenceburg demand charges questioned in Case Nos. 11-5906-EL-FAC, 12-3133-
8 EL-FAC, 13-0572-EL-FAC, 13-1286-EL-FAC, and 13-1892-EL-FAC (the "*FAC Audit*"
9 proceedings). This result continues to hold true once the energy credit is corrected as
10 supported by Company witness Allen. Consequently, there is no reasonable basis to
11 conclude that AEP Ohio has recovered the disputed demand charges more than once.

12 **Q. HOW DID THE COMPANY COMPUTE AND UPDATE ITS COST OF**
13 **CAPACITY FOR THE PERIOD IN WHICH IT WAS SUPPLYING CAPACITY**
14 **TO ALL OHIO LOAD?**

15 A. The Company computed its incurred capacity costs applicable for each of the three PJM
16 Planning Years, which run from June through May (i.e., 2012/13, 2013/14, and 2014/15),
17 utilizing the most recent FERC Form 1 information. The capacity cost computation is a
18 standard cost of service calculation that includes taking balance sheet assets net of
19 accumulated depreciation and other items to compute total rate base. This rate base is
20 then multiplied by the approved return on rate base that represents the cost of capital to
21 fund these assets. The dollars required to earn this return on rate base are then added to
22 the operating expenses subject to recovery to determine the total revenue requirement.
23 The Company utilized the same method and adjustments authorized by the Commission

1 in its Opinion and Order in the *Capacity Charge* case. The Company's calculation of its
2 incurred costs was provided to Baker Tilly Virchow Krause, L.L.P. ("Baker Tilly")
3 during the course of its audit in the *FAC Audit*.

4 **Q. DID BAKER TILLY REVIEW THOSE CALCULATIONS?**

5 A. Yes, Baker Tilly conducted a thorough review to determine the Company's actual cost of
6 the capacity consistent with the Opinion and Order. Furthermore, the Commission Staff
7 provided oversight to Baker Tilly during the course of this audit. The final audit, dated
8 October 6, 2014, is titled "*An Investigation to Determine Whether Ohio Power Company*
9 *is Double-Recovering Capacity Costs Related to Power Purchased from Affiliates*
10 *Lawrenceburg Generating Station and Ohio Valley Electric Corporation*" ("Audit
11 Report"). In Section 3.1.2 on page 10 of the Audit Report, Baker Tilly describes the
12 following procedure:

13 2. Compared the methodology used by AEP-Ohio for calculating future
14 year's \$/MW-day to verify that it corresponded with the State
15 Compensation Mechanism. (Note: Although AEP-Ohio calculates a
16 much higher rate than the \$188.88/MW-day cost cap, the tariffs used are
17 based on the \$188.88/MW-day).

18 On page 10 of the Audit Report, Baker Tilly describes the purpose of this procedure as
19 the following:

20 To determine that AEP-Ohio's calculation methodology is consistent for
21 both calculations

22 As evidence that the Company performed these updates consistently, Baker Tilly found
23 the following in its results on page 10 of the Audit Report:

1 During our testing, nothing came to our attention that would suggest that
2 AEP-Ohio used a different methodology to determine the \$/MW-day for
3 future years or to suggest noncompliance with using \$188.88/MW-day
4 cost cap for the capacity charges.

5 Such a finding provided verification by an independent third party that the Company
6 performed the updates in a manner consistent with the *Capacity Charge* Opinion and
7 Order. As a result, the Company's actual incurred costs over the 3-year period of
8 \$384.28/MW-day, was audited and found to be compliant with this Opinion and Order.
9 This \$384.28/MW-day capacity cost, as confirmed by the Baker Tilly audit, appropriately
10 includes all adjustments made by the Commission in the *Capacity Charge* Opinion and
11 Order prior to netting with the energy and ancillary services credits.

12 **OVEC AND LAWRENCEBURG DEMAND CHARGES**

13 **Q. WHAT ARE THE OVEC AND LAWRENCEBURG DEMAND CHARGES?**

14 A. These are the purchased power demand charges incurred by the Company that are
15 associated with its share of the OVEC generation plants known as Kyger Creek and
16 Clifty Creek and the Lawrenceburg combined cycle plant owned by AEP Generating
17 Company.

18 **Q. WERE THESE CHARGES INCLUDED IN THE ORIGINAL DEVELOPMENT** 19 **OF THE \$355.72/MW-DAY DEMAND CHARGE CALCULATED BY THE** 20 **COMPANY, BUT WHICH WAS ULTIMATELY SET BY THE COMMISSION** 21 **AT \$188.88/MW-DAY?**

22 A. Yes. The fact that the OVEC and Lawrenceburg demand charges were included in the
23 2010 data used during the *Capacity Charge* case to support the \$355.72/MW-day demand

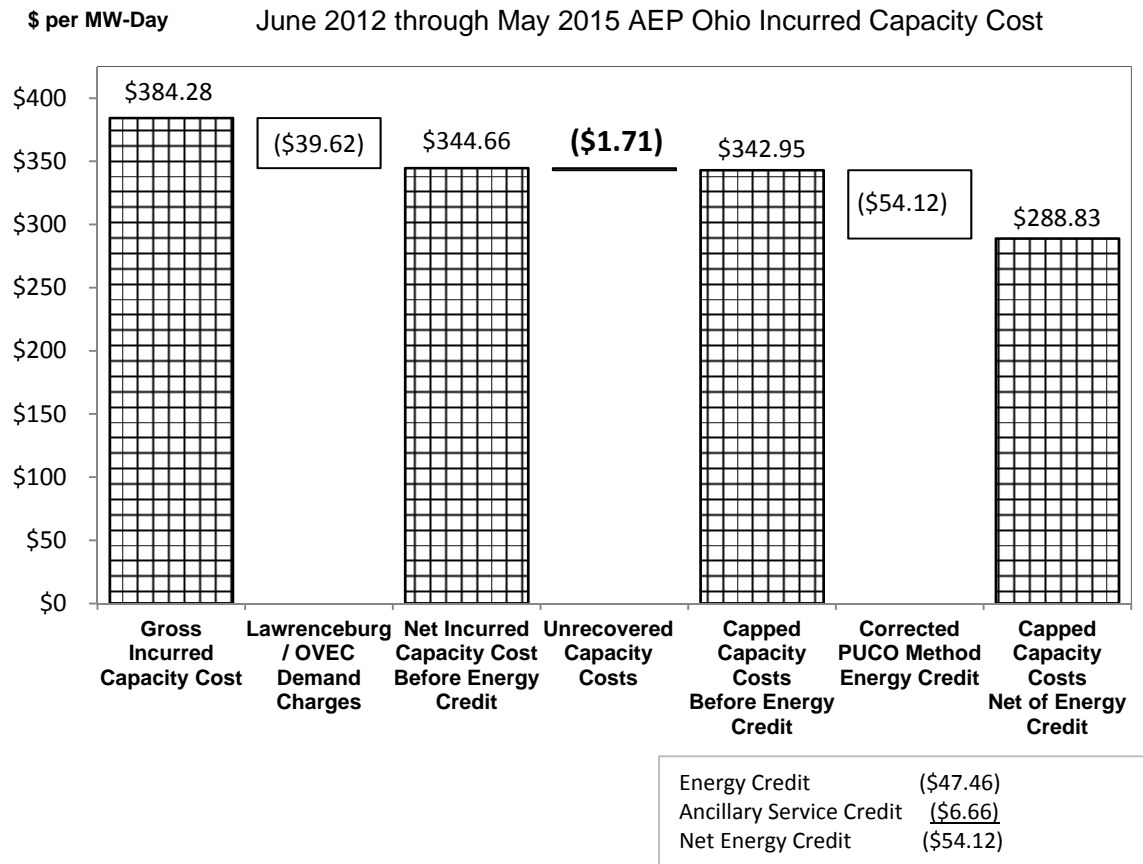
1 charge calculated by the Company has never been disputed. But those demand costs are
2 not part of what was collected through the \$188.88/MW-day demand charge ordered by
3 the Commission. Instead, the OVEC and Lawrenceburg demand costs were recovered
4 through the Fixed Cost Recovery (“FCR”) Rider and, before that, the Fuel Adjustment
5 Clause (“FAC”), and these demand costs were not part of the total costs either collected
6 through the State Compensation Mechanism (“SCM”) or identified for future recovery.
7 This will be established by my testimony. Consequently, there is no “double recovery.”

8 **CAPACITY COSTS INCURRED**

9 **Q. WHAT LEVEL OF CAPACITY COST WAS INCURRED AND RECOVERED**
10 **DURING THE THREE-YEAR PERIOD ENDING MAY 2015?**

11 A. As shown in Figure 1, the Company’s total capacity costs, prior to the netting of the
12 energy credit, averaged approximately \$384/MW-day over the three-year period from
13 June 2012 through May 2015 as previously stated. This amount includes Lawrenceburg
14 and OVEC costs. Next, and most importantly, the OVEC and Lawrenceburg demand
15 charges of approximately \$40/MW-day are removed as shown in Figure 1. This provides
16 a value of incurred costs, prior to the application of the energy credit, of approximately
17 \$345/MW-day. Since the Company’s cost is capped as shown at approximately
18 \$343/MW-day, which becomes the \$288.83/MW-day after it is netted with the energy
19 credit, there is an under-collection of approximately \$2/MW-day as shown in Figure 1.
20 This demonstrates that Lawrenceburg and OVEC demand costs were not collected
21 through the capacity rate, and thus are not being double-recovered

**Figure 1 – AEP-Ohio’s Capacity Cost Excluding OVEC and Lawrenceburg Capacity Costs,
Reconciled to Corrected Cost Cap**

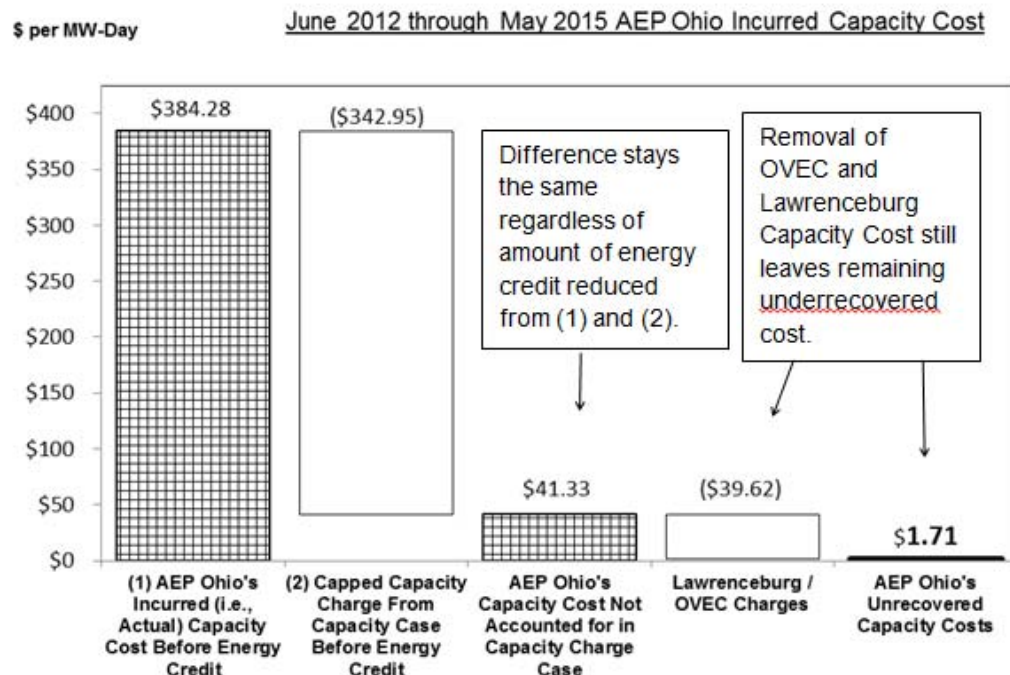


1 **Q. IS THERE AN ALTERNATIVE WAY TO CONSIDER THIS RESULT?**

2 A. Yes. Figure 1 is presented to clarify how the relevant values reconcile to Company
3 witness Allen’s corrected cost cap of \$288.83/MW-day. However, the most relevant item
4 related to my testimony is the unrecovered cost, which, as shown in Figure 2, provides
5 another approach that arrives at the same conclusion. As shown in Figure 2, no matter
6 what level of energy credit is subtracted from (1) the Company’s incurred costs and (2)
7 the capped costs, the difference or “spread” between these two is unaffected and remains
8 \$41.33/MW-day. This means that even with no collection whatsoever of

Lawrenceburg and OVEC demand charges through the SCM, the Company still under-collected its incurred capacity costs by the approximate \$2/MW-day shown.

Figure 2 – Unrecovered Capacity Cost Excluding OVEC and Lawrenceburg Capacity Costs, Reconciled to Corrected Cost Cap



AMOUNT OF UNDER-RECOVERY OF CAPACITY COSTS

Q. HAVE YOU COMPUTED THE DOLLAR AMOUNT OF UNDER-RECOVERY OF CAPACITY COSTS?

A. Yes I have. The Company has incurred capacity costs of approximately \$1.617 billion, prior to the application of the energy credit, to support non-Standard Service Offer (“SSO”) load over the 36-month period ending May 31, 2015. These capacity costs are computed consistent with the *Capacity Charge* Opinion and Order, and do not include any OVEC or Lawrenceburg costs. However, the comparable capped costs, prior to the

1 application of the energy credit, were \$1.609 billion. As a result, the Company has
2 under-collected approximately \$8 million of its incurred capacity costs. This under-
3 collection reflects the subsidy that the Company provided to non-SSO load for the use of
4 its capacity to supply customers excluding any OVEC or Lawrenceburg demand charges.

5 The final step is to modify the values above to reflect the energy credit, but the
6 under-collection “spread” of \$8 million between the incurred and capped costs does not
7 change since the energy credit is applied to both values.

8 **Q. DOES THE \$8 MILLION VALUE REFLECT THE IMPACTS OF REMOVING**
9 **OVEC AND LAWRENCEBURG DEMAND CHARGES FROM THE INCURRED**
10 **COSTS?**

11 A. Yes, it does, and since these costs reflect the under-recovery once OVEC and
12 Lawrenceburg demand charges have already been removed, I submit that there is no other
13 further adjustment needed since costs should not be removed *twice*.

14 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

15 A. Yes it does.

CERTIFICATE OF SERVICE

In accordance with Rule 4901-1-05, Ohio Administrative Code, the PUCO's e-filing system will electronically serve notice of the filing of this document upon the following parties. In addition, I hereby certify that a service copy of the foregoing Direct Testimony of Kelly D. Pearce was sent by, or on behalf of, the undersigned counsel to the following parties of record this 7th day of June, 2016, via electronic transmission.

/s/ Steven T. Nourse

Steven T. Nourse

EMAIL SERVICE LIST

aaragona@eimerstahl.com;
aehaedt@jonesday.com;
afreifeld@viridityenergy.com;
Amy.spiller@duke-energy.com;
Bojko@carpenterlipps.com;
campbell@whitt-sturtevant.com;
arthur.beeman@snrdenton.com;
bakahn@vorys.com;
BarthRoyer@aol.com;
bkelly@cpv.com;
cblend@porterwright.com;
bmcmahon@emh-law.com;
bpbarger@bcslawyers.com;
callwein@wamenergylaw.com;
carolyn.flahive@thompsonhine.com;
cathy@theoec.org;
cendsley@ofbf.org;
christopher.miller@icemiller.com;
clinton.vince@snrdenton.com;
cmontgomery@bricker.com;
cmooney@ohiopartners.org;
cynthia.a.fonner@constellation.com;
dakutik@jonesday.com;
dan.barnowski@snrdenton.com;
Dan.Johnson@puc.state.oh.us;
Dane.Stinson@baileycavalieri.com;
Daniel.Shields@puc.state.oh.us;

dboehm@BKLawfirm.com;
drinebolt@ohiopartners.org;
David.fein@constellation.com;
dconway@porterwright.com;
dparram@taftlaw.com;
dianne.kuhnell@duke-energy.com;
djnichalski@hahnlaw.com;
dmeyer@kmklaw.com;
Doris.McCarter@puc.state.oh.us;
Dorothy.corbett@duke-energy.com;
doug.bonner@snrdenton.com;
dstahl@eimerstahl.com;
dsullivan@nrdc.org;
eisenstatl@dicksteinsharpiro.com;
Elizabeth.watts@duke-energy.com;
emma.hand@snrdenton.com;
etter@occ.state.oh.us;
fdarr@mwncmh.com;
gary.a.jeffries@dom.com;
gpoulos@enernoc.com;
Maureen.willis@occ.ohio.gov;
Greg.Price@puc.state.oh.us;
gregory.dunn@icemiller.com;
greta.see@puc.state.oh.us;
glpetrucci@vorys.com;
gthomas@gtpowergroup.com;

ghiloni@carpenterlipps.com;
haydenm@firstenergycorp.com;
henryeckhart@aol.com;
Hisham.Choueiki@puc.state.oh.us;
holly@raysmithlaw.com;
jmcdermott@firstenergycorp.com;
jejadwin@aep.com;
Jeanne.Kingery@duke-energy.com;
jeff.jones@puc.state.oh.us;
jestes@skadden.com;
jhummer@uaoh.net;
jkooper@hess.com;
jlang@calfee.com;
jmaskovyak@ohiopoverlylaw.org;
jkylercohn@BKLawfirm.com;
john.jones@puc.state.oh.us;
Jonathan.Tauber@puc.state.oh.us;
joseph.clark@directenergy.com;
joliker@igsenergy.com;
judi.sobecki@DPLINC.com;
keith.nusbaum@snrdenton.com;
kern@occ.state.oh.us;
kguerry@hess.com;
Kim.Wissman@puc.state.oh.us;
kinderr@dicksteinsharpipro.com;
korenergy@insight.rr.com;
kpkreider@kmklaw.com;
kwatson@cloppertlaw.com;
laurac@chappelleconsulting.net;
lehfeldtr@dicksteinsharpipro.com;
lkalepsclark@vorys.com;
lmcbride@calfee.com;
malina@wexlerwalker.com;
mkurtz@BKLawfirm.com;
mjsettineri@vorys.com;
Michael.dillard@thompsonhine.com;
mpritchard@mwncmh.com;
matt@matthewcoxlaw.com;
mchristensen@columbuslaw.org;
msmalz@ohiopoverlylaw.org;
mwarnock@bricker.com;
ned.ford@fuse.net;

ohioesp2@aep.com;
paul.wight@skadden.com;
pfox@hilliardohio.gov;
Philip.Sineneng@ThompsonHine.com;
Randall.griffin@DPLINC.com;
rburke@cpv.com;
ricks@ohanet.org;
rjhart@hahnlaw.com;
rmason@ohiorestaurant.org;
ascenzo@duke-energy.com;
rremington@hahnlaw.com;
rsugarman@keglerbrown.com;
sam@mwncmh.com;
sandy.grace@exeloncorp.com;
Sarah.Parrot@puc.state.oh.us;
sbruce@oada.com;
small@occ.state.oh.us;
ssalamido@cloppertlaw.com;
ssolberg@eimerstahl.com;
stephanie.chmiel@thompsonhine.com;
smhoward@vorys.com;
Stephen.chriss@wal-mart.com;
stnourse@aep.com;
steven.beeler@puc.state.oh.us;
swolfe@viridityenergy.com;
talexander@calfee.com;
Stephen.Reilly@puc.state.oh.us;
Tammy.Turkenton@puc.state.oh.us;
terrance.mebane@thompsonhine.com;
terry.etter@occ.ohio.gov;
Thomas.Lindgren@ohioattorneygeneral.gov;
thomas.mcnamee@ohioattorneygeneral.gov;
thompson@whitt-sturtevant.com;
tlindsey@uaoh.net;
toddm@wamenergylaw.com;
todonnell@bricker.com;
tdougherty@theOEC.org;
trent@theoec.org;
tsantarelli@elpc.org;
tsiwo@bricker.com;

Werner.margard@ohioattorneygeneral.gov;
whitt@whitt-sturtevant.com;
william.wright@ohioattorneygeneral.gov;
wmassey@cov.com;
yost@occ.state.oh.us;
zkraivtz@cwsllaw.com

This foregoing document was electronically filed with the Public Utilities

Commission of Ohio Docketing Information System on

6/7/2016 4:12:02 PM

in

Case No(s). 10-2929-EL-UNC, 11-0346-EL-SSO, 11-0348-EL-SSO, 11-0349-EL-AAM, 11-0350-EL-AAM

Summary: Testimony -Direct Testimony of Kelly D. Pearce on Behalf of AEP Ohio
electronically filed by Mr. Steven T Nourse on behalf of Ohio Power Company